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Property

Real Property Law Changes for the 1995-96 Legislative Year

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I. INTRODUCTION

Two new laws this session make dramatic strides in the areas of municipal utilities and real property assignments. Chapter 24 offers welcome relief to landlords and other property owners who have been required to pay their tenants' delinquent utility bills.¹ It essentially closes the window on tenant "free-loaders" who default, and adds needed clarity to the area of utility deposits.² Chapter 49 affects the definitions of real property assignments and provides greater recourse for lenders who accept assignments as a form of collateral on a loan.³ Further, it sets forth a specific method for enforcing assignments in loan default situations.⁴ This Legislative Note will examine the effects of and reasoning behind the two new laws.

II. CHAPTER 24

A. Legal Background

Private and municipally-owned public utility companies provide water, gas, electricity, and sewer service to residents.⁵ Landlords, in turn, facilitate their tenants' hook-ups to these utilities.⁶ In a typical situation, the landlord, through the utility company, provides separate utility meters for each tenant, allowing each tenant to be billed directly by the utility company.⁷ Considering that the tenants are billed directly for their services, one might conclude that the tenant would be expected to pay the bill.

1. See CAL. PUB. UTIL. CODE §§ 10016, 12811.5(a) (amended by Chapter 24) (adding phrases to the law specifically prohibiting the shifting of delinquent bills to landlords and property owners).

2. See *id.* §§ 10009.6(c), (d), 10016(b), (c), 12811.5(b), (c), 12822.6(c), (d) (amended by Chapter 24) (establishing amounts for utility deposits and providing for their use in the event of delinquency).

3. See CAL. CIV. CODE § 2938 (enacted by Chapter 49) (explaining the procedures for enforcing a real property assignment in the event of loan default).

4. See *id.* (eliminating the distinction between real property assignments and real property assignments used as security).

5. See CAL. PUB. UTIL. CODE § 216(a), (b) (West 1997) (defining "public utility" and listing the services they provide).

6. See *Rental Property Owners No Longer Have to Pay Utility Bills Left Unpaid by Tenants*, Bus. Wire, Apr. 29, 1996, available in LEXIS, News Library, Curnws File [hereinafter *Rental Property Owners*] (illustrating that landlords provide individual meters for each unit instead of maintaining one meter for all units).

7. See *id.* (noting that utilities will no longer be able to transfer charges from individually metered units to the property owner).

Under prior law, however, landlords were required to pay for the delinquent bills of their tenants.⁸ Prior law made landlords responsible for the delinquent utility charges of their tenants.⁹ If the utility was unable to collect the amount due from the tenant, the municipal utility could acquire a lien on the property.¹⁰ This lien was given the "force, effect, and priority of a judgment lien on the property."¹¹ The landlord could remove the lien at the recorder's office once the delinquent amount was paid in full.¹² This absolved tenants of responsibility for the delinquent amounts, while financially burdening the landlord.

Prior law provided an additional means for a municipal water utility to make the landlord, or property owner, a guarantor for future tenants.¹³ The law provided that subsequent to nonpayment of a water bill by a tenant, service to future tenants could be provided on the landlord or property owner's account.¹⁴ This required landlords to collect the monthly water bill from their tenants and limited the landlord's options if the tenant refused to pay. Prior law did not provide the means for a landlord to compel the municipal utility to revert back to individual tenant billing, subsequent to the billing being transferred to the landlord's account.¹⁵

Because the landlord could have been held responsible for delinquent tenant accounts,¹⁶ there was little incentive for the utility to prescreen a tenant's credit history. However, the law allowed utility districts to require a deposit from new residential applicants.¹⁷ The problem was that the law did not specify a means to determine how much could be collected as security.¹⁸ Additionally, the law did not explicitly state that the deposit could be used by the utility to pay delinquent service charges.¹⁹ Given the ambiguity, municipal utilities used landlords as security deposits.

B. Similar Law in Other States

Similar to California before the enactment of Chapter 24, New Hampshire and Wisconsin make landlords the guarantors of their tenants' utility bills.²⁰ The New

8. 1987 Cal. Stat. ch. 254, sec. 2, at 1257 (amending CAL. PUB. UTIL. CODE § 12811.1(a)).

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* (amending CAL. PUB. UTIL. CODE § 12811.1(b)).

13. 1985 Cal. Stat. ch. 1251, sec. 4, at 4304 (enacting CAL. PUB. UTIL. CODE § 12811.5).

14. *Id.*

15. *See id.*

16. *See* 1987 Cal. Stat. ch. 254, sec. 2, at 1257 (enacting CAL. PUB. UTIL. CODE § 12811.1) (allowing a utility to require the owner of the property to pay for the services provided to the tenant).

17. 1989 Cal. Stat. ch. 1066, secs. 4-6, at 3681-82 (enacting CAL. PUB. UTIL. CODE §§ 10009.6, 12822.6, and 14681.6).

18. *See id.*

19. *See id.*

20. *See infra* notes 21-24, 27-28 and accompanying text.

Hampshire law allows municipal utilities to assess landlords for gas, water, or electric bills left unpaid by tenants.²¹ Like California's previous approach, New Hampshire law provides for landlords to be assessed indirectly through property liens.²² This lien may be enforced by a lawsuit if the property owner fails to satisfy the lien.²³ New Hampshire utilities, however, may only procure a lien for certain charges.²⁴ Liens may be levied only for charges "of which the owner of the real estate was notified . . . within 120 days of the date the charges became delinquent."²⁵ The utility may meet this requirement by mailing the utility bills concurrently to the tenant and the landlord.²⁶

Similarly, Wisconsin makes landlords pay a "deadbeat tenant's" bill.²⁷ This is true for both electric and water bills left unpaid by tenants.²⁸ In clandestine fashion, the utility company bills the landlord by adding to the property tax bill.²⁹ The utilities do not even warn the landlord if the tenant is late; they just charge the landlord's property tax bill.³⁰ These practices sparked apartment owners and real estate lobbies to push for legislative changes.³¹ These changes move in the direction of California's new Chapter 24, and will likely pass the Wisconsin Legislature by the end of the year.³²

C. Effects of Chapter 24

With respect to municipally owned utilities or municipal utility districts, Chapter 24 alters the methods by which utilities may collect delinquent bills from tenants.³³ It accomplishes this end by explicitly defining the phrase "subsequent tenant" to exclude any adult who lived at the residence during the time the delinquent charges accrued.³⁴ This is significant considering that both prior law and Chapter 24 prohibit

21. N.H. REV. STAT. ANN. § 38:22(I) (1996); *see id.* (providing that "[a]ll charges for services furnished to patrons by a municipally owned gas, water, or electric works shall create a lien upon the real estate where such services are furnished"); *see also Utility Collection Bill Moves to Senate*, WIS. ST. J., Jan. 26, 1996, at 3D (explaining that existing Wisconsin law requires landlords to pay delinquent tenant utility bills).

22. N.H. REV. STAT. ANN. § 38:22(II)(b) (1996).

23. *Id.* § 38:22(II)(c) (1996).

24. *Id.* § 38:22(II)(d) (1996).

25. *Id.*

26. *Id.*

27. *See* WIS. STAT. ANN. § 66.069 (West Supp. 1996) (allowing delinquent tenants' bills to be transferred to the landlord for payment); *see also Utility Collection Bill Moves to Senate*, *supra* note 21, at 3D.

28. WIS. STAT. ANN. § 66.069 (West Supp. 1996).

29. Edmund S. Tijerina, *Pending Legislative Compromise Pleases Municipally Owned Utilities*, MILWAUKEE J. SENTINEL, Nov. 17, 1995, at 2; *see id.* (explaining that landlords were often charged for delinquent tenant bills without even knowing that their tenants were delinquent).

30. *Id.*

31. *Id.*; *see id.* (noting that "apartment owners and real estate lobbies banded together to create a bill that would do something about what they saw as an injustice").

32. *Id.*

33. *See* CAL. PUB. UTIL. CODE § 12811.5(a) (amended by Chapter 24).

34. *Id.*

the collection of delinquent water bills from "subsequent tenants."³⁵ In short, it prevents a tenant from claiming, after a cotenant leaves, that they are now a subsequent tenant and not required to pay the delinquent bill.³⁶

Further, Chapter 24 eliminates the ambiguity in security deposits and their use by municipal utilities. Prior law allowed municipal utilities to collect security deposits, but did not specify the amount that a municipal utility could collect.³⁷ Now, the law provides that the security deposit may not "exceed twice the estimated average periodic bill or three times the estimated average monthly bill."³⁸ Moreover, the law allows municipal utilities to use that amount to pay a delinquent tenant's account.³⁹ This finally authorizes utilities to put security deposits to their intended use.

Chapter 24 allows landlords to keep their tenants' names off their personal utility bill.⁴⁰ Prior law required that following default by a tenant, utility service to subsequent tenants would be "furnished on the account of the landlord or property owner."⁴¹ Today, a landlord need not worry about becoming a guarantor of the delinquent utility bills of an irresponsible tenant.

D. Arguments

The California Apartment Association, who sponsored Chapter 24, sees its passage as the end of an "unfair practice that allowed some irresponsible renters to ignore their debts."⁴² This phrase reflects the prevalent feeling among apartment owners and managers.⁴³ From the perspective of owners, the law shifts the responsibility back to where it should be properly laid, at the feet of the individual renter.⁴⁴

35. *Id.*; 1989 Cal. Stat. ch. 1066, sec. 4-5 at 3681-82 (enacting CAL. PUB. UTIL. CODE §§ 12822.6, 16481.6).

36. CAL. PUB. UTIL. CODE § 12811.5(a) (amended by Chapter 24) ("[T]he term 'subsequent tenant' shall not include any adult person who lived at the residence during the period that the charges accrued.").

37. *See* 1989 Cal. Stat. ch. 1066, sec. 4, at 3680 (enacting CAL. PUB. UTIL. CODE § 12822.6).

38. CAL. PUB. UTIL. CODE § 10009.6(c) (enacted by Chapter 24); *see id.* § 12811.5(b) (enacted by Chapter 24) (providing provisions identical to California Public Utilities Code § 10009.6 in a separate code section).

39. *Id.* § 12811.5(c) (enacted by Chapter 24); *see id.* (allowing a tenant's security deposit to be applied to the final bill in the event of nonpayment); *see also id.* § 10009.6(d) (enacted by Chapter 24) (applying the same changes as California Public Utilities Code § 12811.5(c)).

40. *Id.* § 10016(a) (amended by Chapter 24); *see id.* (specifying a utility may not require a tenant be listed on the landlord's bill).

41. *Compare id.* § 12811.5(a) (amended by Chapter 24) (stating that utilities "may not require that services to subsequent tenants be furnished on the account of the landlord") with 1985 Cal. Stat. ch. 1251, sec. 4, at 4304 (enacting CAL. PUB. UTIL. CODE § 12811.5) (suggesting that utilities "may" require subsequent tenants to be furnished on a landlord's bill).

42. *Rental Property Owners*, *supra* note 6.

43. *See* Bob Findle, *New State Law Leaves Collection of Unpaid Water Bills Murky*, SAN DIEGO UNION-TRIB., June 23, 1996, at H-1 (noting property managers and apartment owners who are pleased by the new law).

44. *Id.*

For instance, Joe Carta, of Joe Carta Realty, expresses the sentiment that a landlord should not be responsible for a tenant's bill.⁴⁵

Municipal water districts do not share the sentiments of apartment owners.⁴⁶ Last year, the San Diego Water Utility Department wrote off \$323,000 in delinquent bills.⁴⁷ Other municipal utilities write off large amounts each year, as well.⁴⁸ This leads to the feeling among municipal utility providers that owners should be required to pay the bills that their tenants fail to pay.⁴⁹ Municipal utilities view owners as those with the greatest ability to pay, and therefore believe that they should be held ultimately responsible for the unpaid bills.⁵⁰ The owner is, in fact, better able to pay because he owns the property.⁵¹

For municipal utilities that relied on liens to collect delinquent amounts, Chapter 24 may have an adverse financial impact.⁵² The municipal utilities using the lien method for delinquent bill collection will have to find an alternative.⁵³ Opponents argue that this legislation places municipal utilities at an unfair disadvantage, because private utilities are not covered by the new law.⁵⁴ The only real alternative collection tactic is to use security deposits, which are limited to three times the average monthly bill.⁵⁵

Apparently, the legislature does not equate ability to pay with responsibility to pay.⁵⁶ Chapter 24 marks the beginning of a new era for municipal utilities. It illustrates a shift back to individual accountability, and gives landlords and property owners one less financial burden to worry about.

45. *Id.*

46. *Id.*

47. *Id.*; *see id.* (noting that this amount "is not broken down between owners and tenants").

48. *Id.*; *see id.* (listing amounts ranging from \$50,000 to \$60,000 that are written off each year by municipal water utilities).

49. *See id.* (quoting various municipal utilities who think that landlords, and not the public, should be required to guarantee their tenants' utility bills).

50. *See id.* (quoting the president of the Apartment Owners Association, Don Faller, who notes that "[t]he only reason the utilities have been doing it this way is that the owner is stable and is easy to collect from").

51. *Id.*

52. Corrie Anders, *Landlord Hooks Tenants with Internet*, FRESNO BEE, May 26, 1996, at F-5; *see id.* (noting that "Stockton Municipal Utilities District placed \$982,000 worth of such [utility bill] liens on rental property owners").

53. *See id.* (illustrating that municipal utilities previously relied on liens to collect on delinquent bills).

54. ASSEMBLY FLOOR, COMMITTEE ANALYSIS OF AB 1770, at 2 (Mar. 25, 1996).

55. *Id.*

56. *See* CAL. PUB. UTIL. CODE §§ 10009.6, 10016, 12811.1, 12811.5, 12822.6 (amended by Chapter 24) (providing that landlords, or property owners, may not be made to pay tenants' delinquent utility bills).

III. CHAPTER 49

A. Background

Under prior law, “a written assignment of interest in rents, issues, and profits of real property made in connection with a loan secured by real property . . . constitute[d] a present transfer of the assignor’s interest.”⁵⁷ Once the assignor executed and delivered the assignment, it became effective.⁵⁸ Subsequently, recording the assignment “perfected” it on the day that it was recorded.⁵⁹ Additionally, “a written assignment of the rents, issues, and profits of real property, stating that it is given as additional security, [was] perfected upon recording and relieve[d] the assignee of the necessity to obtain possession of the real property.”⁶⁰ Moreover, the assignee did not need to take any additional action to preserve his interest in the property.⁶¹

B. The Effect of Chapter 49

Chapter 49 completely revamps assignment law with respect to the creation of security interests, making it easier for lenders to safeguard their loans and recover when borrowers default.⁶² The new law particularly affects real estate loans where the borrower assigns rental income to the lender as collateral on the loan.⁶³ It lets lenders begin collecting the rents paid on the property by tenants, if the borrower defaults.⁶⁴ The process to collect the rents is explicitly stated in Chapter 49, and even contains a form which lenders may use to demand that the rent be paid to them directly.⁶⁵

As noted, the rent collection process begins with default.⁶⁶ The lender then takes at least one of four steps to “reroute” the rent from the landlord to the lender’s bank.⁶⁷ First, the lender may appoint a “receiver” over the property, to facilitate the collection of rents previously paid to the borrower.⁶⁸ Second, the lender may obtain the

57. 1991 Cal. Legis. Serv. ch. 501, sec. 1, at 2160 (enacting CAL. CIV. CODE § 2938).

58. *Id.*

59. *Id.*

60. See SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF SB 947, at 1 (May 6, 1996) (describing existing California Civil Code § 2938.1).

61. *Id.*

62. *New California Law to Aid Lenders in Defaults on Real Estate Transactions*, Bus. Wire, May 17, 1996, available in LEXIS, Nexis Library, Curnws File [hereinafter *New California Law to Aid Lenders*]; see *id.* (explaining and listing the protections afforded to lenders by Chapter 49).

63. *New CA Law Protects Commercial Lenders*, NAT’L MORTGAGE NEWS, June 10, 1996, at 7 [hereinafter *New CA Law*].

64. CAL. CIV. CODE § 2938(a) (enacted by Chapter 49).

65. *Id.* § 2938(c), (d) (enacted by Chapter 49).

66. *Id.* § 2938(c) (enacted by Chapter 49).

67. *Id.* § 2938(c) (enacted by Chapter 49); see *id.* (referring to the four steps as “enforcement steps”).

68. *Id.* § 2938(c)(1) (enacted by Chapter 49); see *New California Law to Aid Lenders*, *supra* note 62 (explaining that the new law “validates” the lender’s right to appoint a receiver).

"rents, issues, or profits" from the defaulting borrower.⁶⁹ Third, the lender may deliver a written demand to one or more of the tenants to turn over their rents to the lender by utilizing the demand form provided by the law.⁷⁰ Fourth, the lender may send a written demand directly to the assignor for the collection of "rents, issues, or profits of the real property . . . to which the recorded assignment was to be mailed after recording."⁷¹ This notice is also sent to all assignees of record.⁷² Any one, or all, of these steps can be taken by the lender.⁷³

Collection by the assignee (lender) of any amounts from the assignor (borrower/landlord) will not diminish or eliminate any liens or other collateral that the assignee has in the property.⁷⁴ Moreover, the actions taken pursuant to Chapter 49 will not violate § 726 of the California Code of Civil Procedure.⁷⁵ Lastly, such actions taken pursuant to Chapter 49 will not "limit any right available to the assignee with respect to its security."⁷⁶ The new law assists the lender in properly securing the lender's interests.

The new law also eliminates the confusion over different types of assignments by designating all assignments as "additional security."⁷⁷ According to proponents, this is one of the law's greatest contributions.⁷⁸ Prior to Chapter 49, courts grappled with different kinds of assignments and different remedies for the violation of each.⁷⁹ By classifying all as "additional security," courts will be able to more easily mete out remedies, when assignments must be enforced.⁸⁰ Additionally, the law provides "rights [for] individual lenders when multiple lenders have claims to the same property."⁸¹

Chapter 49 brings clarity to a challenging area of the law, namely assignments. It insures that lenders' security interests, when in the form of an assignment, are protected and easily collected in the event of default. Moreover, it provides a coherent

69. CAL. CIV. CODE § 2938(c)(2) (enacted by Chapter 49).

70. *Id.* § 2938(c)(3) (enacted by Chapter 49).

71. *Id.* § 2938(c)(4) (enacted by Chapter 49).

72. *Id.*

73. *Id.* § 2938(c) (enacted by Chapter 49).

74. *Id.* § 2938(f)(1) (enacted by Chapter 49); see Steve Stwora-Hail, *Legislature Is Working During an Election Year*, DAILY RECORDER (Sacramento, Cal.), May 28, 1996, at 2 (noting that "monies received by the assignee pursuant to [Chapter 49] shall not result in a loss of any lien or security interest . . . in the underlying real property or any other collateral").

75. CAL. CIV. PROC. CODE § 2938(f)(1) (enacted by Chapter 49); see *id.* § 564(d) (amended by Chapter 49) (providing that a case brought to enforce an assignment and following the guidelines in § 2938 shall not constitute a violation of California Code of Civil Procedure § 726).

76. Stwora-Hail, *supra* note 74, at 2.

77. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 947, at 3 (May 6, 1996).

78. See *id.* (stating that according to the Real Property Law Section of the California State Bar, "this bill is necessary to establish clear laws regarding the rights of assignors and assignees under an assignment of leases and profits clause").

79. *Id.*

80. See *id.*

81. *New CA Law, supra* note 63, at 7.

plan for lenders to follow when confronted with the difficult situation of a borrower's default.

IV. CONCLUSION

This year the legislature worked out fundamental changes to real property law. To cries of "Unfair!" the legislature responded to landlords and property owners who were tired of paying for tenants' delinquent bills.⁸² It is now municipal utilities who cry, because their favorite collection method is prohibited.⁸³ For lenders, the legislature also heeded their cries; a long-confused system of assignments and collection practices befuddled many lenders.⁸⁴ Now, lenders likely feel more secure when a borrower asks to use a real property assignment as collateral.⁸⁵ To lenders and landlords alike, it was a glorious year.

APPENDIX

Code Sections Affected

Public Utilities Code §§ 10009.6, 10016, 12811.1, 12811.5, 12822.6 (amended).

AB 1770 (Brewer); 1996 STAT. Ch. 24

Civil Code §§ 2938, 2938.1 (new and repealed); Code of Civil Procedure § 564 (amended).

SB 947 (Beverly); 1996 STAT. Ch. 49

82. See Findle, *supra* note 43, at H-1 (expressing that landlords should be pleased that the new law frees them from paying "deadbeat tenants" bills).

83. See *id.* (expressing the chagrin of utilities who may no longer rely on landlords as guarantors for tenants' utility bills).

84. See *New California Law to Aid Lenders*, *supra* note 62 (explaining that the new law aids lenders by clarifying assignments of rents used as security).

85. *Id.*